TESTIMONY OF

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Before the

U.S. HOUSE OF REPRESENTATIVES

RESOURCES COMMITTEE,

ENERGY AND MINERAL RESOURCES SUB-COMMITTEE

relating to H.R. 2952

THE POWDER RIVER BASIN RESOURCE DEVELOPMENT ACT OF 2000

ON BEHALF OF PEABODY ENERGY CORPORATION

AND

THE NATIONAL MINING ASSOCIATION

OCTOBER 11, 2001

Good Afternoon, Madam Chairman:

My name is Ryan Tew. I am Senior Counsel for Peabody Energy Corporation. I am appearing here, not just on behalf of my company, but also on behalf of the National Mining Association ("NMA"), to testify in favor of H.R. 2952, The Powder River Basin Resource Development Act, which has been introduced by Chairman Cubin.

General Introduction

Peabody Energy Corporation, headquartered in St. Louis, is the largest coal producer in the United States. In 2000, our operating subsidiaries mined 181.6 million tons of coal - approximately 16.9% of the nation's production -- from surface and underground mines in Wyoming, Arizona, Indiana, Montana, Colorado, Illinois, West Virginia, Kentucky and New Mexico. This coal fuels more than 9% of the electricity generated in the United States.

In 2001, we expect to mine more than 100 million tons of low-sulfur, sub-bituminous coal from our three surface mines in the Powder River Basin ("PRB") of Wyoming - North Antelope/Rochelle, Caballo and Rawhide. Some of you have been to North Antelope/Rochelle, the Nation's largest surface mine and have seen the quality of work and environmental reclamation we conduct. For those of you who have not, I would like to extend an invitation to you.

The National Mining Association (NMA) represents producers of over 80 percent of America's coal, a reliable, affordable, domestic fuel that is the source for over fifty percent (50%) of the electricity that America uses today. NMA also represents companies that produce metals and non-metals, companies that are among the nation's larger industrial energy consumers. Members also include manufacturers of processing equipment, machinery and supplies, transporters, and engineering, consulting and financial institutions serving the mining industry.

Powder River Basin Discussion

The Powder River Basin (PRB) coal field, located in Wyoming and Montana, includes over one trillion tons of coal reserves " in place". Over 60 billion tons of these reserves are known to be economically recoverable with today's technology. The PRB contains a truly extraordinary seam of coal, the Wyodak. The seam ranges from 60 - 90 feet in thickness and geologically resembles an enormous, elongated bowl that is roughly 80 miles across and 120 miles long. The first map indicates its size and location. There are 14 large surface mines in the PRB of Wyoming, all producing coal from the eastern edge (or the outcrop) of the Wyodak seam. These mines are all located at a point where the coal seam is most shallow - where it virtually intercepts the surface. As the seam moves west, it gets progressively deeper and actually thicker, as it quickly reaches depths that are not economically recoverable with either today's surface or underground mining techniques. PRB coal represents 32% of the coal produced in the United States.

This enormous coal reserve contains coal that is low in sulfur and is also low in inherent NOX when burned in power plants. As a result, coal production in the PRB has increased dramatically over the past two decades rising from just under 95 million tons per year in 1980 to nearly 350 million tons in 2000. PRB coal, delivered to 124 U.S. power plants in 26 states offers a primary source for low cost electricity generated from coal.

Whether viewed as an economic or as a domestic energy security and reliability issue, continued coal production from the PRB is critically important to the United States. It is equally important to the people of Wyoming. In 1999, PRB coal production generated nearly $202 million in state and local property taxes; $193.5 million in federal royalties (shared equally by the United States and Wyoming); almost $116 million in abandoned mine land fees and $72.9 million in black lung taxes;and tens of millions of dollars in payroll taxes, income taxes, etc. In total, coal produced from Wyoming represented over $3.2 billion to the total economy of that state. Although the precise data is not yet completed, the economic impact of the coal produced in the year 2000 from the PRB will mean even more revenue for Wyoming than in 1999.

Conflicts Background

A brief history of mineral leasing demonstrates the need for H.R. 2952.

Virtually all of the coal and approximately 50% of the oil and gas in the PRB is owned by the federal government and managed by the Bureau of Land Management (BLM), Department of Interior under the Mineral Leasing Act of 1920. The remaining oil and gas is owned either by private landowners, conveyed under homestead laws enacted in 1920 and 1916, or by the States, conveyed under the statehood acts. Mineral developers have leased vast tracts of these minerals from their federal, State, or private owners.

The conflicts exist because BLM has issued both federal coal leases and federal oil and gas leases for the same locations in the PRB. It also has leased federal coal in areas that have already been leased by private landowners or the State for oil and gas development. In those areas leased both for coal and for oil and gas ("common areas"), disputes over timing of mineral development have arisen. For safety and operational reasons the resources typically cannot be developed concurrently. The sequence of development in the common areas frequently becomes a critical issue, because production of any one of the minerals can result in the loss of another. For example, the CBM will be vented if the coal is mined first; the coal may be bypassed if the CBM is produced first. Even if a mineral is not lost, major costs can be incurred due to the delay or interruption in that mineral's development to accommodate another mineral's earlier production (e.g., the costs of plugging a deep gas or oil well below the coal seam and removal of gathering lines until mining is completed, or of delaying the progression of the coal mine until production of the oil or gas ceases).

No clear statutory direction exists to resolve disputes over the sequence of mineral development in the PRB's common areas. The BLM provided no guidance to its lessees, and set no conditions in its leases, for the resolution of these disputes. Even after the BLM issued its official "Policy on Conflicts between Coal Bed Methane and Coal Development" on February 22, 2000, the agency's officials in the field have continued to inform federal lessees in the common areas that they must work out mineral development disputes on their own, without BLM's assistance or direction. In addition, the BLM continues to issue both coal leases and oil and gas leases - and to approve both mine plans and applications to drill - in the same locations in the PRB. In short, the de facto policy of BLM merely to direct the companies to work out the issues among themselves continues as it has for the last 25 years.

As a result of the absence of dispositive federal law or policy, coal developers and oil and gas developers in the PRB's common areas have attempted to negotiate private mineral development agreements. The few agreements reached to date require the coal developers to pay the oil and gas developers to ensure that mines on federal leases can continue to operate. The coal developers believe these agreements are inequitable, because the coal operators have made major capital investments and do not have the flexibility to alter their mining plans to accommodate oil and gas wells. The oil and gas developers seek unreasonable compensation, because the coal developers simply cannot afford extended negotiations or prolonged litigation in the face of the economic consequences of idling drag lines, paying royalties on unmined bypassed federal coal, and dealing with breached contractual obligations. Another representative of the coal industry from the PRB testified before this Subcommittee in the last Congress that his company estimated that past agreements have called for payments to the oil and gas developers of 3 to 5 times the fair market value of the unproduced oil and gas. This situation is not isolated.

Lengthy Negotiations or Extended Litigation are not Viable Alternatives

Generally, we agree that the best parties to resolve issues of conflict are those who know the most about their own businesses - the coal company which wishes to exercise the rights granted it to extract coal under its federal coal lease, and the oil and gas producer which has drilled a well or wells into oil and gas bearing horizons. But, unfortunately, sometimes these issues cannot be worked out reasonably. Sometimes, people are not reasonable. Companies which operate coal mines in the PRB have frequently learned that the price of mining through an existing oil and gas well is the payment of excessive payments. The federal lessor frequently is not paid its full share of the royalty on the payment made by the coal developer to oil and gas developer nor is the State of Wyoming rendered its statutory share. BLM indirectly promotes this behavior, nevertheless, by the absence of any policy governing conflicts in multiple mine development.

Some representatives in the oil and gas industry contend that the principle of "first in time, first in right" governs matters of conflict in multiple mineral development. This principle means to them that the first entity which was issued a lease, whether it be to a coal or oil & gas company, must be given the complete and unfettered right to develop its reserve without interference from the junior holder. While "first in time, first in right" is certainly a well established principle of oil and gas law, it has not been applied to coal conflict situations, as some in the oil and gas industry suggest. Historically, it is a rule of law that has applied to conflicts in title to disputed property. It is not a rule that governs the priority of development of different mineral estates.

The common law has resolved conflicts between oil and gas versus coal or other solid mineral lessees by relying on other principles. We would suggest that the rule of accommodation is more appropriately applicable. Furthermore with regard to lands covered under the 1909 and 1910 Coal Lands Act, in which the U.S. reserved the coal when issuing land grants, the U.S. Supreme Court has suggested in at least one case, that "first in time, first in right" actually may have been established at the time the U.S. originally reserved its coal rights, not when the coal was leased.

Federal coal leasing statutes and regulations require that federal coal lessees meet diligent development, maximum economic recovery, and continuous operations requirements or pay penalties in the form of royalties on bypassed coal, advance royalties, or even lease forfeiture. These constraints restrict coal developers' ability to undertake prolonged litigation to resolve the legal questions raised above. Business considerations including contractual obligations to utility customers exacerbate the predicament. Operational factors involving the movement or idling of massive and expensive machinery, as well as the economic plight of thousands of mine workers in PRB, play into the resolution of resource conflicts the coal operator never contemplated when it made the decision to pay millions of dollars in bonus bids for the right to mine the federal coal resource.

All of these considerations weigh on the coal lessee when it must decide whether to endure extended litigation. These same concerns enter into the decision to undertake lengthy negotiations in a market skewed by the fact that the value is not determined between a willing seller and a willing buyer, but rather between a coal lessee and an oil and gas developer who is not confronted by similar statutory or economic constraints. In short, our business enterprise is being held for ransom.

The cards are further stacked against a coal producer by an intentionally transparent process of providing information and public participation. Under the terms of the Surface Mining Control Reclamation Act of 1977 ("SMCRA"), before we are able to obtain a permit to mine, we must submit a very detailed mining and reclamation plan to both the state and federal government regulators covering the life of the mine. As an initial part of that process, we usually must go through the NEPA process of EIS preparation, which involves extensive public participation. Additionally, we are required by both federal and state statutes to go through another, very extensive, round of public participation, in that we must submit a written notice to every owner of any interest whatsoever within the life of mine permit area as well within one half mile outside the permit area, advising each of them of our pending operations and giving each of them an opportunity to object. In fact, we must explain to each of them how they can object if they choose.

Over the years oil and gas interests have come keenly to appreciate their leveraging position in the mine permitting process. In fact, it is typical for the Wyoming Department of Environmental Quality to receive protest notices from some individual oil producers in or around a coal mine permit area who demand that the operations not continue unless the oil and gas owner is somehow satisfied (usually financially). As a coal industry, despite the inequity, we have come to terms with this process, and we deal with it.

H.R. 2952 will provide a predictable and fair resource development dispute resolution mechanism where negotiations are unsuccessful and extended litigation will prejudice coal lessees and needlessly add to already crowded federal court dockets.

CBM Development

The issues described thus far concern the conflict in developing two different minerals, each of which occupy a different physical space (deep oil and gas) as well as CBM. As difficult as this situation has been since the 1970s, it became infinitely more complicated in 1998 with the increased potential for coal bed methane development. Unlike the traditional conflict, Coal and CBM conflicts pit two owners, one seeking to extract gas from the very coal seam leased by the other.

It is important to recognize that coal operators that bid on federal coal leases in the conflict area prior to the potential for CBM development did not take into economic consideration in preparing their respective bid packages the potential of conflicting coal bed methane development. How could they? BLM itself has acknowledged that they did not take such conflicting development into account in their economic equation. The BLM did not even believe that coal bed methane existed in economically recoverable quantities when these leases were made available.

If coal companies bidding for the leases in the conflict area had known of the potential for conflicts with other coal bed methane developers, they likely would have discounted their bids significantly. It is fundamentally important to recognize that, unless a provision such as that which is contained in H.R. 2952 to allow a royalty credit for such coal bed methane conflict resolution payments is enacted, Peabody and other producers of coal from federal leases will suffer considerable damages. Coal lessees in the conflict area have paid hundreds of millions of dollars for leases which contain significantly diminished rights and economic benefits compared to those that BLM represented they would receive as the successful bidder. If H.R. 2952 is not enacted, future coal bids will likely be significantly discounted, thus resulting in diminished revenues to both the Federal and Wyoming governments.

BLM's February 22, 2000 Conflicts Policy

On February 22, 2000, BLM released a new policy that purportedly deals with issues of conflict. In some limited respects, the contents of the policy are a step in the right direction; in other areas, it is a major step in the wrong direction. However, this policy fails to deal in any manner whatsoever with the questions before us today: What happens if conflicting parties with existing leases cannot reach agreement? Without legislation, an agency policy cannot adequately address existing coal and oil and gas leases, (particularly where wells already exist or coal bed methane wells now scheduled are drilled in the PRB) and where there is imminent conflict.

Without legislation, coal producers will be exposed to paying an ever increasing ransom, far in excess of fair market value to mine coal that the federal government leases with an implicit promise of development. The coal industry must have a mechanism to resolve conflicts if agreements cannot be reached. We believe that the provisions embodied in the H.R. 2952 represent that solution.

Concerns Raised by Opponents of H.R. 2952

The attached maps depict the vastness of the Power River Basin coal field and the coal bed methane that is contained therein, indicates that less than 2% of the PRB area has conflicts between coal and coal bed methane development. 98% of coal in the PRB is not economically recoverable now or in the foreseeable future, so we are dealing with an area of potential conflicts that represent a very, very small portion of the total Basin area.

Some opponents of the bill argue that the bill will establish an adverse precedent in other areas. This clearly is not the case. By its very terms, it is applicable only to a limited and defined portion of PRB and will not change existing law with regard to other areas of the country or other minerals. Section 17 at the bottom of page 26 of H.R. 2952 provides expressly that:

SEC. 17. DENIAL OF USE AS PRECEDENT. "Nothing in this Act shall be applicable to any lease under the Mineral Leasing Act or the Mineral Leasing Act for Acquired Lands for any mineral, or shall be applicable to, or supersede any statutory or common law otherwise applicable in, any preceding in any Federal or State court involving development of any mineral outside of the common area and within or outside the Powder river Basin."

Simply put: H.R. 2952 is not a precedent for wider application.

Industry Position on H.R. 2952

NMA and Peabody Energy favor private resolution of conflict issues, wherever and whenever possible. The conflict resolution proceedings established by H.R. 2952 would only be implemented on those occasions when disagreements persist and a third party must enter and resolve the dispute. H.R. 2952 would provide the missing statutory direction to resolve these mineral development disputes. It would establish a formal dispute resolution proceeding to be used only in the common areas within the maps designated "Dispute Resolution Area" in the Wyoming portion of the Powder River Basin and only as a last resort if private negotiations and the February 22, 2000 BLM administrative policy fail.

Nothing in this bill prevents BLM from adopting policies or promulgating regulations as to how conflicts can and should be resolved in the longer term to avoid the 'last resort' mechanism specified in H.R. 2952. And, as a practical matter, the H.R. 2952 mechanism likely will only be employed a few times in the court, because the parties will quickly realize the fair market value methodologies which are utilized by the panel of three experts and will thereafter resolve their differences through private negotiations, without the need for seeking judicial intervention.

This dispute resolution proceeding would (i) determine whether the suspension of an oil and gas lease or development right in a common area within the Dispute Resolution Area is necessary in order to allow coal development to continue in accordance with the mine plan, and (ii) calculate, and provide for the payment of the lost net income and fixed costs to the owners of the suspended oil and gas lease or right to develop.

It must be re-emphasized that the bill requires the mineral developers to negotiate a possible resolution of each dispute first. If both negotiations and BLM's conflict policy fail, either the coal developer or the oil and gas developer can invoke the formal resolution proceeding established by filing a petition with the local federal court. Without these resolution mechanisms, if negotiations collapse, coal development in the PRB and the many of the benefits derived by the State of Wyoming and the federal treasury could be significantly reduced. As a result, the Nation's largest source of its most abundant, affordable and reliable energy resource could be compromised.

In short, Peabody Energy Corporation and NMA maintain that the passage of H.R. 2952 is very important to the orderly development of energy resources in the designated Wyoming portion of the Powder River Basin.

Conclusion:

The provisions of the Powder River Resource Development Act will reduce uncertainties, promote expeditious resource recovery, and establish a fair and predictable procedure for resolving resource development conflicts in the area representing approximately 2% of the PRB coal region where conflicting leases and existing mines already exist.

In summary, H.R. 2952 would merely establish that, if an oil or gas well is in conflict with imminent coal production, the oil and gas developer will receive full and fair market value for the well, even if the lease is junior in time to the coal operator's. In addition, the legislation will actually reduce confusion and conflict (and thus the potential for litigation between the parties - including the United States) and will strengthen BLM's ability to require diligent development of coal bed methane operations. Very significantly, H.R. 2952 will increase revenue to both the federal and Wyoming treasuries by establishing an economic foundation which results in full, undiscounted federal coal bonus bidding rather than the present situation, which will likely result in coal companies discounting significantly their bids in anticipation of payments (usually 3-5 times fair market value) to oil and gas operators that are in conflict.

We particularly appreciate the valuable guidance, direction and leadership of Chairman Cubin on this legislation. We all thank you for your leadership, Madam Chairman. We, as Wyoming Powder River Basin coal producers, and the National Mining Association, believe that H.R. 2952 represents a fair piece of legislation which requires urgent and favorable consideration.

Thank you very much for your time. I will be happy to answer any questions you might have.